

COMMISSIONER'S COMMENTS



Patrick M. McQueen

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Commissioner

Another fast-moving year has passed with many important events in the financial services industry and at the Financial Institutions Bureau. I am pleased to report that Michigan's financial services industry is strong and successful. Our state's robust economy has contributed much to the overall soundness of its financial institutions, while the underpinning of this strong economy has been the very good health of our financial institutions.

Michigan is a national giant in terms of state-chartered commercial banks and credit unions. We rank 4th in the nation in state-chartered bank assets at \$99.6 billion with 35,727 full-time bank jobs. Michigan is number 2 in the country in credit union assets, which totaled \$12.1 billion at year end 1998 and we have the third largest number of state-chartered credit unions, now totaling 315, excluding Central Corporate Credit Union. Michigan is clearly a leader in the delivery of financial services.

This, the 110th annual report, will review the substantial work of the Bureau's four regulatory divisions, highlight the activities of our two support divisions, and discuss trends we see in the financial industries we supervise.

Some highlights of Bureau activity during 1998 include:

- Regulatory fees paid by banks and credit unions were lowered 4 percent and 2.8 percent, respectively. FIB activities are funded 100 percent by regulatory fees and each of our programs is self-funded.
- Both the Bureau's Bank & Trust Division and Credit Union Division received reaccreditation from their national professional associations.
- The Bureau completed its reorganization, prompted by early retirements:
 - FIB staff was reduced by 6 percent at a time when the volume of work expanded, nearly doubling in the mortgage-licensing program. The Bureau currently has 122 employees, 11 less than in 1993.
 - We have achieved a "flatter" organization to enhance efficiency and to streamline delivery of services to the constituencies we serve.
 - With the retirement of Russell S. Kropschot, Gary K. Mielock was appointed Chief Deputy Commissioner, and Donald P. Mann, Roger W. Little, and Peggy L. Bryson were appointed Deputy Commissioners.
- The Bureau completed its annual strategic plan with improvement plans developed for each division.

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- The Bureau continues to use technology to provide improved service to consumers, and more effective and efficient regulation of the financial industry. Our examiners can access federal regulatory systems, implement computerized examinations, and have dial-in access to the FIB network that permits them to file examination documents electronically.
 - There was significant expansion and improvement to the FIB Internet Site. Our Web Site makes available, at the click of a mouse, applicable statutes, rules, regulations, bulletins, interpretative letters for each regulated industry, application and complaint forms, and news and consumer information.

I hope you are reading this report via the Internet...it is our intention next year to save thousands of dollars by publishing this report almost exclusively in electronic form. Another of our goals for the coming year is to make our Web Site more interactive so that forms can be filed via the Internet, and consumer and industry inquiries can be asked and answered electronically.

- We commenced an independent study of the mortgage application process to identify ways to streamline and reduce burden to Michigan businesses. Implementation of the new process begins in late spring, 1999.
- OmniBank: The Bureau successfully worked through the first state-chartered bank closure in Michigan since 1988. After months of working to help salvage the bank, it became apparent that the bank's failure was unavoidable. To help ensure the economic well-being of the communities served by OmniBank, it was important that a sound bank be positioned to take over the failed bank.

In an innovative move, the Bureau encouraged a group of the 8 largest financial institutions in the state to commit their time and money

to aid in structuring a successful bid package acceptable to the FDIC. With this assistance, ShoreBank, Detroit, assumed all the deposit liabilities of the failed bank...including millions of dollars in public funds from the cities of Detroit, Highland Park, and River Rouge.

All deposits of OmniBank were protected, and the state gained a highly respected new bank in the Detroit area.

- An unprecedented 12 new banks were approved by the Bureau in 1998. Included in that number was Detroit Commerce Bank, the first new state-chartered bank in the city of Detroit in 29 years.
- The consolidation of 6 banks and 145 branches, located in four states of the Midwest, was accomplished in the latter part of 1998. CNB Bancshares of Indiana had 1 bank in Michigan (Pinnacle Bank, St. Joseph). Following approval of the consolidation, the new entity became the fourth largest state-chartered bank in Michigan.
- Legislation: This was a quiet legislative year for the financial services industry.
 - The Bureau successfully countered legislation that would have prohibited financial institutions from imposing surcharges on ATM transactions, or would have subjected them to duplicative disclosure requirements.
 - The Bureau drafted legislation which resulted in PA 371 and 372, which allows the Commissioner to exempt nonprofit mortgage lenders from licensure under the Mortgage Brokers, Lenders, and Servicers Licensing Act.
 - The Bureau drafted legislation that modernizes the entire Michigan Banking Code of 1969. It is anticipated that Senator Joanne Emmons will introduce the

proposed legislation during the 1999 legislative session.

Promoting Year 2000 readiness for the institutions we regulate continues to be one of the highest priorities of the Bureau. Each of our line divisions, in cooperation with their federal counterparts, has been working with financial institutions to help ensure that Y2K plans are in place. The five key phases of an effective Year 2000 program for financial institutions include Awareness, Assessment, Renovation, Validation (testing), and Implementation. By June 30, 1999, banks and credit unions should be finished with all testing, validation, and implementation of mission critical systems.

Based on the extensive reviews we have made, I want to emphasize that Michigan state-chartered banks and credit unions are adequately preparing for the millennium date change. More detail on the regulatory programs for Year 2000 readiness is found in each division section of this report.

Michigan's 315 state-chartered credit unions recorded another impressive growth year in 1998. Assets rose over \$1.3 billion, a growth rate of 12 percent, ending the year with \$12.1 billion in total assets. Share deposits grew 12.5 percent in 1998. Loan demand in Michigan has also remained strong and credit unions have been accommodating. Loans grew 7.3 percent during the year, bringing the loan to deposit ratio to a level of 69.9 percent.

Our state-chartered banks also benefited greatly from, and contributed to, Michigan's healthy economy. In 1998, bank assets increased over \$12.3 billion, a 14.2 percent increase from last year, and now totaling over \$99.6 billion.

Lending by Michigan banks also continues to be strong due to continuing high loan demand. The balance sheets show an increase of 12.8 percent in loans during 1998, generating nearly \$73 billion

in loans outstanding. The loan to deposit ratio at year-end stood at 98.7 percent.

The Michigan state savings bank charter is relatively new: the legislation establishing the charter was enacted in 1996. Subsequent to that date, the Bureau has approved five state savings bank charters. The state savings bank charter is an attractive alternative for many institutions, and we expect additional charter conversion applications in the coming year.

State-chartered savings banks posted total consolidated assets of \$2.9 billion, representing a 6.3 percent increase over the previous year. Return on assets compare very favorably with national averages: state-chartered savings banks reported an aggregate net income of \$31 million for 1998, representing a 10.7 percent increase over year end 1997 totals. The aggregate return on average assets for savings banks was 1.11 percent.

Michigan has, like the rest of the nation, experienced considerable consolidation and merger activity in the banking industry. But at the same time, and I believe as a result of the consolidation activity and the strong economy, the number of new state-charter applications has risen substantially. During 1998, the Bureau chartered 12 new banks, and new applications continue to arrive at our corporate section at a steady pace. The availability of capital, talented bankers, and market demand for community banks contribute to this growth.

The consumer finance licensees, particularly in the mortgage broker/lender area, have grown an incredible 39 percent in the two-year period, 1997 and 1998. The strong economy, low interest rates, and the relative ease of entry into the market contributed to this explosive growth.

The rapid growth in this industry is not without cost. The Consumer Finance Licensing and Enforcement Division conducted important

enforcement actions during the year, resulting in license revocations as well as license denials. Additionally, the division processed 550 written consumer complaints filed against licensees, a 70 percent increase over 1997.

The most significant trend in the financial services industry continues to be the blurring of lines between deliverers of the services. Insurance companies offer banking products, banks sell insurance, mortgage companies apply for thrift charters...the examples are endless. Geographic boundaries have eroded; technology permits providers in Alaska or Rhode Island (or any other state) to offer services to residents of any state, without the need for brick and mortar.

A major vehicle for this blurring of lines has been the re-emergence of the federal thrift charter. The thrift charter has become a popular vehicle for scores of businesses to own a bank and combine banking with insurance, securities, and other commercial activities. For example, in Michigan, Jackson National Life has acquired a federal thrift, and AAA has applied for a thrift charter. State Farm opened its bank in Illinois in March of 1999, with near-term plans to offer traditional banking products through their insurance agent's offices across the nation.

HR 10 (Financial Services Act) which would modernize the financial services industry, still has not passed Congress. The legislation is again on the Senate Banking Committee's agenda in 1999, but swift passage is unlikely. This legislation is needed: modernization of the industry is taking place, driven by the market, and in some cases accommodated by the regulators. As ABA President R. Scott Jones put it, "In the time that Congress was debating what a bank should be, State Farm became one."

The credit union movement is very healthy...and growing. But I believe credit unions may be overly

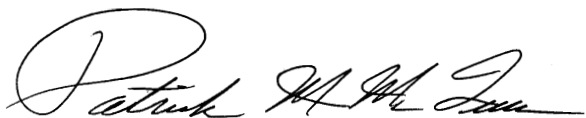
focused on their victory on the field of membership issue. HR 1151, which confirmed an expanded field of membership for nationally chartered credit unions, was perhaps a Pyrrhic victory...and no victory at all for state-chartered credit unions. The Congressional "fix" to the Supreme Court's earlier ruling on credit union field of membership didn't change field of membership rules for state charters, but did saddle them with more restrictive business loan requirements and PCA's.

The trends are clear. Michigan's consumers are demanding faster and easier access to services, and they are demanding more diverse services from each provider. Each of the differing financial service providers highlighted in this report serves a valued purpose. It is critical that consumers have the right and the option to form relationships with the financial institution of their choice.

The financial services industry is undergoing dramatic change. Because of heightened competition, technology, and economic factors, our regulated entities need to sharpen their strategic plan focus, continue to invest in technology, and institute value-added services to establish long-lasting customer relations. Competition will continue to be fierce. Innovation and creativity in providing what customers want and need will distinguish the winners from the losers.

The Financial Institutions Bureau will, as it has for the past 110 years, work to ensure that financial institutions operate safely, soundly, and in compliance with applicable law. We will work to ensure that a variety of financial services are available to meet the needs of Michigan's citizens. And we will work to provide a full range of competitive opportunities to financial institutions, and to keep pace with the changes in the financial services industry.

I am proud of the high level of service that our staff provides. We will continue to further improve our service to the people of the state of Michigan by providing the best, highest quality, state-of-the-art supervision of the state financial institutions system. We look forward to working with you in 1999.

A handwritten signature in black ink, reading "Patrick M. McQueen". The signature is fluid and cursive, with the first name "Patrick" being the most prominent.

Patrick M. McQueen
Commissioner